

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-150177-06

In Re:

Date:
March 26, 2007

Legend:

- Settlor =
- Trust =
- Husband =
- State =
- State Court =

- State Statute =
- Date 1 =
- Date 2 =
- Date 3 =

Dear _____ :

This letter responds to a letter, dated October 16, 2006, from your personal representative, requesting a ruling under § 2601 of the Internal Revenue Code.

The facts submitted and the representations made are as follows. Settlor established an irrevocable trust (Trust) on Date 1. Date 1 is before September 25, 1985. Paragraph First of Trust provides that Trust is to be divided into three trusts, Trust A, Trust B, and Trust C.

Paragraph First (a) provides that during Settlor's lifetime the net income from Trust A is to be accumulated and added to principal. Paragraph First (b) provides that during Settlor's lifetime the net income from Trust B is to be paid to the Settlor and upon Settlor's death to her husband (Husband) if he survives Settlor. Paragraph First (c) provides the during Settlor's lifetime trustee is to distribute the net income from Trust C to Husband "or any descendant of the Settlor in the event of need occasioned by illness,

accident or other misfortune, or any emergency, or if in the discretion of such individual Trustee it is necessary for the comfortable maintenance, support or education of any such beneficiary or of his or her family..."

Paragraph First (d) provides as follows:

At the time of the execution of this Trust Indenture, the Settlor has living three children, However, this Trust Indenture and its benefits shall extend to all children and issue of deceased children of Settlor whether now living or hereafter born. From and after the death of the Settlor or upon the death of [Husband] in the event he survives the Settlor as her husband, the Trustee shall set off the entire trust, including each of the parts into which it had previously been divided, and the accumulated but undistributed income thereon, into one or more portions, and if more than one, then as nearly equal in value as possible, one share for each of the children of the Settlor who shall at that time be (1) living, or (2) deceased but leaving living lawful issue then surviving, such issue to take in equal parts subject to the terms hereof, the share set off for their deceased parent or ancestor, per stirpes, however, and not per capita. Thereafter the Trustees shall pay not less frequently than quarter annually to the beneficiary or beneficiaries of each share or portion during the continuance of the trust established in respect to the share or portion of such child or lawful issue of deceased child, so much of the net income derived from such share or portion as the individual co-trustee may in his sole and absolute discretion determine and direct. In the event of the death of any beneficiary for whom a share or portion as above provided has been set aside leaving lawful issue, said lawful issue shall be entitled to receive any discretionary distribution of income from the share or portion theretofore set aside for the deceased ancestor of such surviving issue without necessity of future adjustment for unequal distribution. In the event there is no such surviving issue of any beneficiary, or all of such surviving issue shall thereafter die, the share or portion theretofore set aside, for which there is no such surviving issue to become beneficiary, shall be added to and become a part of the remaining shares or portions just as if it had constituted as part thereof at the time of the death of survivor of Settlor and her husband, [Husband]. Twenty years after the death of the last survivor of the Settlor and her husband, [Husband], and all of the children of the Settlor living at the date of the execution of this trust, the trust herein created shall terminate and shall be distributed, free and clear of all trusts, to the descendants of the Settlor then living who have no living ancestor who is a descendant of Settlor, per stirpes and not per capita. (Emphasis added)

Paragraph First (f) provides that in the event Settlor and Husband are not survived by “descendants” or the descendants cease before the Trust terminates, Trust is to be terminated and distributed to those persons who would inherit under State law if Settlor had died intestate.

In Paragraph Third (d), Settlor retained the right by her Last Will and Testament to direct a contrary disposition of the income from Trust B. Settlor’s current Will directs that after her death Trust B is to be maintained as a separate portion from which the trustee is to distribute income to her descendants. Accordingly, under the third sentence of Paragraph First (d) only Trusts A and C will be combined after Settlor’s death.

Husband died on Date 2. On Date 3, Settlor’s great-grandchild was born out of wedlock. It has been represented that under State law, Settlor’s great-grandchild would not be considered the “lawful issue” of Settlor because the child’s parents were not married when the great-grandchild was born.

The trustee of Trust contends that the use of the term “lawful issue” in sentences 3 through 6 of Paragraph First (d), instead of the words “descendant” or “issue” constitutes scrivener’s error for the following reasons. First, the term “lawful issue” while used in sentences 3 through 6 of Paragraph First (d) is not used in other parts of the same paragraph or in any other paragraph of Trust.

Second, the use of the term “lawful issue” in sentences 3 through 6 of Paragraph First (d) directly contradicts sentence 2 of that paragraph, which states that “this Trust Indenture and its benefits shall extend to all children and issue of deceased children of the Settlor whether now living or hereafter born.” (Emphasis added)

Third, the terms “descendant” and “issue” are used in the following paragraphs of Trust without being qualified by the term “lawful.” The phrase “any descendant of the Settlor” is used in Paragraph First (c) relating to discretionary distributions from Trust C during Settlor’s lifetime. The second sentence of Paragraph First (d) states that “this Trust Indenture and its benefits shall extend to all children and issue of the deceased children of the Settlor whether not living or hereafter born.” The terminating provisions set forth in the last sentence of Paragraph First (d) provides that the terminating distributions are to be made to “the descendants of the Settlor then living who have no living ancestor who is a descendant of Settlor, per stirpes and not per capita.” Paragraph First (f) of Trust refers to the terminating distributions that are to be made if “no descendents of the Settlor” are then living.

Fourth, the use of the term “lawful issue” in sentences 3 through 6 of Paragraph First (d) but not elsewhere in Trust leads to the following illogical and inconsistent results. Pursuant to Paragraph First (c), Settlor’s great-grandchild as a “descendant” is eligible to receive discretionary distributions from Trust C during Settlor’s life. Pursuant to sentences 3 through 6 of Paragraph First (d), Settlor’s great-grandchild as a descendant

who is not “lawful issue” will not be eligible to receive discretionary distributions from Trusts A and C (Descendant’s Trusts) between the date of Settlor’s death and the date those trusts terminate. Pursuant to the last sentence of Paragraph First (d), Settlor’s great-grandchild as a “descendant” will be entitled to receive distributions upon the termination of the Descendants’ Trusts if he survives to the termination date. Pursuant to Settlor’s exercise of her testamentary power to direct a contrary disposition of the income from Trust B, Settlor’s great-grandchild will be eligible to receive discretionary distribution from Trust B between the date of Settlor’s death and the date Trust B terminates.

Settlor has executed an affidavit in which she has indicated that she does not recall advising the attorney who drafted Trust, or any other person, that any of her descendants should be excluded from the class of beneficiaries eligible to receive distributions from any trust created under Trust, and she does not recall discussing the matter with the attorney or any other person. Settlor has indicated that it is not presently her intent, and she does not recall ever having the intent, to exclude a descendant of hers from receiving distributions from any trust created under Trust. Finally, Settlor represents that she has executed numerous wills and trust indentures that refer to her descendants or issue and none of those instruments limits the class of her descendants or issue to those who are deemed “lawful.”

It has been represented that no additions, actual or constructive, have been made to Trusts A, B, or C after September 25, 1985.

The trustee of Trust proposes to file an action in State Court to reform sentences 3 through 6 of Paragraph First (d) of Trust so that those sentences use or refer to the terms “descendants” or “issue” rather than the term “lawful issue.”

State Statute provides that a court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor’s intention if it is proved by clear and convincing evidence that both the settlor’s intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement.

The trustee of Trust requests a ruling that the proposed reformation of Trust will not cause Trust A, Trust B, Trust C, or the Descendants’ Trusts to lose their status as trusts that are exempt (in the case of Trust A, Trust C, and the Descendants’ Trusts) or partially exempt (in the case of Trust B) from the generation-skipping transfer (GST) tax.

Law and Analysis:

Section 2601 imposes a tax on every generation-skipping transfer made after October 26, 1986. A generation-skipping transfer is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term taxable termination means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property.

Section 2612(b) provides that the term taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

Under section 1431(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust except as provided in § 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct scrivener's error will not cause an exempt trust to lose its exempt status provided the judicial action involves a bona fide issue, and the construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(E), Example 3, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be

interpreted by the highest court of the state. Therefore, the trust will not be subject to the provisions of chapter 13.

In the present case, Trust A and Trust C are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies to these trusts. Section 2038 applies to that portion of Trust B's corpus necessary to support the income interest in Trust B because Settlor has retained the right in Paragraph Third (d) of Trust to direct a contrary disposition of the income interest in Trust B in her Last Will and Testament. To the extent that Trust B's entire corpus is not necessary to support the income interest in Trust B, that portion that is not necessary, if any, is considered irrevocable on September 25, 1985. It has been represented that no additions, actual or constructive, have been made to Trust after September 25, 1985.

Trust contains conflicting terms that may lead to an inconsistent administration of its provisions that are the result of a scrivener's error. To resolve this issue, the trustee intends to file, pursuant to State Statute, an action in State Court to have Trust reformed. As reformed, the terms "descendants" or "issue" will replace the term "lawful issue" in sentences 3 through 6 of Paragraph First (d) of Trust. Settlor has presented an affidavit in support of the proposed reformation.

Accordingly, based upon the facts submitted and the representations made, we conclude that the distribution of trust income after Settlor's death and before Trust terminates presents a bona fide issue regarding the disposition of trust property. Further, we conclude that the proposed reformation of Trust is consistent with applicable state law that would be applied by the highest court of the state. Therefore, the proposed judicial reformation of Trust will not cause Trust, Trust A, Trust C, the Descendants' Trusts, or any portion of Trust B that may be deemed irrevocable on September 25, 1985 under § 26.2601-1(b)(1)(ii)(B) to lose their status as trusts that are exempt from the GST tax by reason of §1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning whether any portion of Trust B is irrevocable on September 25, 1985 pursuant to § 26.2601-1(b)(1)(ii)(B). Further, no opinion is expressed or implied concerning what portion of Trust B is includible in Settlor's gross estate under §§ 2036 or 2038.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James F. Hogan

James F. Hogan
Senior Technician Reviewer, Branch 9
(Passthroughs & Special Industries)

Enclosure: Copy for § 6110 purposes

cc: